the technical analyst AWARDS 2011 FINALIST

14th October 2013

Market Update:

Shall we sell Bonds now?

UPDATE
Technical
Fundamental

Disclaimer

Shall we sell Bonds now?

UK Long Gilt 10 yr monthly futures chart

The market has simultaneously broken the long-term bull trend and completed a H&S reversal.

The minimum move implied by the H&S pattern? About 96…

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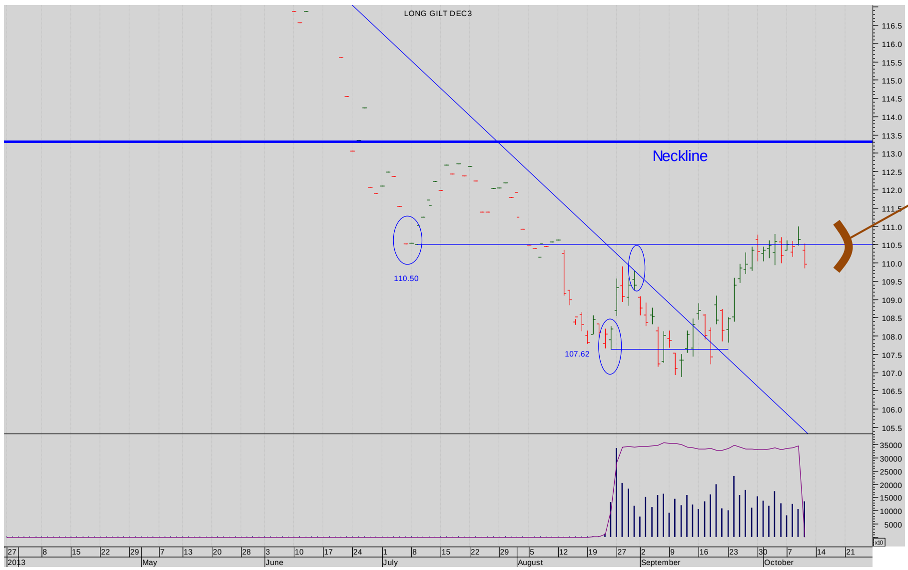

UK Dec Long Gilt 10 yr daily futures chart

The market is struggling to get back through the resistance from the Prior Low

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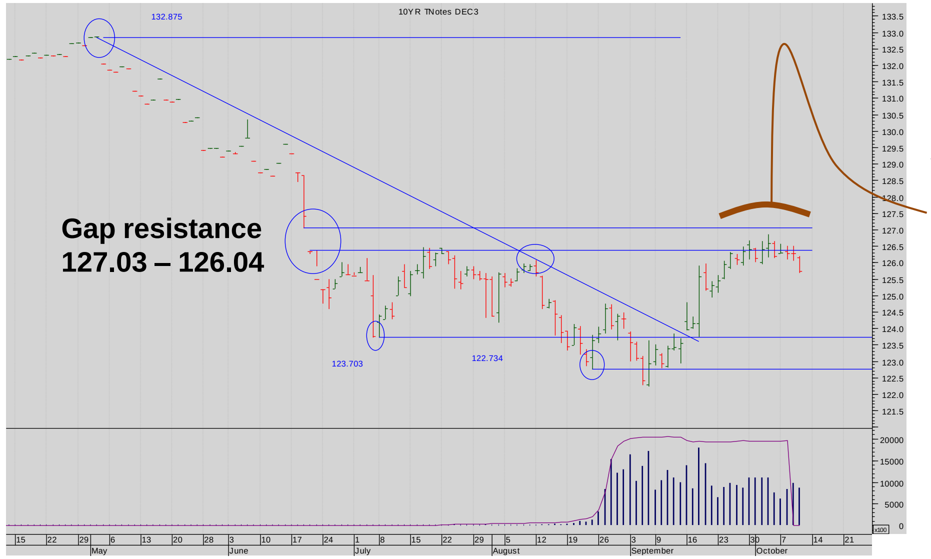

US TNote DAILY futures CHART

The market has failed to break up through the Gap resistance (which we talked about last week).

The second failure at that level looks like the market is vulnerable at the top of a range…

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FUNDAMENTALS:

The US Federal government shut down has had a dramatic impact on markets. What had been a solid year long rally in stocks was brought to a swift end. Similarly, the sell-off in bonds that was developing into a clear bear market was also brought to a halt.

With US policy makers unable to find common ground over the Federal budget and agree a new debt ceiling, the Government of the United States was forced to lay off thousands of employees to preserve what funds it had remaining.

Over the weekend rumours of a deal have vapourised.

Clearly, with so many workers sent home on unpaid furlough there will be an impact on growth as other employers that rely on government contracts have been forced to take similar measures with their employees.

We still believe a default will ultimately be avoided, the clock is ticking down and markets and traders are becoming increasingly uneasy about the prospect of the richest country on earth, with the largest economy and reserve currency defaulting on its obligations.

Were that to happen the US would surely fall into recession as would the global economy. The leaders of China and Japan are naturally uneasy, as they hold trillions of Dollars of US Debt and are urging the US to get its house in order.

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FUNDAMENTALS: CONTINUED

The impact on bonds has not only been an end to the bear run, but a strong corrective rally has set in, as traders turn away from risk such as equities and paradoxically buy bonds.

But what happens if the US does default?

Clearly there would be a sell-off in US Treasuries, but would the US quite literally walk away from those obligations, or would it honour its debts once the budget wrangle and debt ceiling issue was settled?

We believe the US would honour all her debts once the debt ceiling was eventually raised and Bonds, including Treasuries would recover, but at what cost longer term to the US?

The US despite running a massive budget deficit, with a huge debt burden is able to borrow at very favourable rates because she is trusted, default, whether termed as actual or technical would break that trust and the cost of borrowing for the US would be higher than it would otherwise have been.

What then is the outlook for bond markets?

Currently they are a short-term if very risky buy. But when this crisis is resolved, as we think it will be, market attention will revert to the core issues which are the Fed’s policy stance on tapering, the health of the economy and strength of corporate earnings.

The impact on markets will be a resumption of the Bull trend in stocks and a return to bearish price action in bonds. Given the uncertainties, only the brave would sell bonds now right now. Others will want to wait for this crisis to resolve first.

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SEVEN DAYS AHEAD
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